VZCZCXYZ0008
RR RUEHWEB

DE RUEHBO #0007/01 0051835
ZNR UUUUU ZZH
R 051835Z JAN 09
FM AMEMBASSY BOGOTA
TO RUEHC/SECSTATE WASHDC 6348
INFO RUEHBR/AMEMBASSY BRASILIA 8578
RUEHPE/AMEMBASSY LIMA 6862
RUEHCV/AMEMBASSY CARACAS 1474
RUEHQT/AMEMBASSY QUITO 7559
RUEHZP/AMEMBASSY PANAMA 2827
RUEHLP/AMEMBASSY LA PAZ 9854

UNCLAS BOGOTA 000007

SIPDIS
SENSITIVE

WHA/EPSC FOR MROONEY; EEB/OMA ASIROTIC; TREASURY FOR AJEWELL

E.O. 12958: N/A
TAGS: ECON EFIN EINV PGOV CO
SUBJECT: COLOMBIAN ECONOMIC OUTLOOK: WHAT A DIFFERENCE A
YEAR MAKES

REF: A. 08 STATE 134459
¶B. 08 BOGOTA 3076
¶C. 08 BOGOTA 3289
¶D. 08 BOGOTA 4263

¶1. SUMMARY. After four years of averaging over 5 percent growth capped by a record 7.5 percent expansion in 2007, Colombia's economy slowed significantly in 2008 under the combined pressure of currency appreciation and high interest rates in the first semester, and the cratering of commodity prices, international credit and global demand in the second. Turmoil in the economies of Colombia's two largest trade partners, the United States and Venezuela, have further darkened the outlook for 2009 with current growth estimates ranging from 1-3 percent and worries of recession growing. As a result, the GOC has postponed some 2009 administrative outlays, accelerated infrastructure spending, and sought out new trade and investment flows. Rising pressure to free up monetary policy has also led the Central Bank to cut its benchmark rate for the first time in almost three years. Many local analysts say, however, more interest rate cuts and greater emphasis on diversification and competitiveness will be necessary to return Colombia's economy to high sustained growth in the long term. END SUMMARY.

2008: Good Times Winding Down

¶2. (U) While the GOC began 2008 aiming for a soft landing of 5 percent GDP growth, the Colombian economy steadily decelerated over the year along with GOC forecasts. After reducing the growth forecast to 4 percent in October, on December 22, Finance Minister Zuluaga announced that the GOC was lowering its final 2008 GDP growth estimate to 3.5 percent. At the same time, according to Colombia's National Statistics Department (DANE), unemployment rose to 10.8 percent in November compared to 9.4 percent in November 2007. The increase represents 2.1 million Colombians unable to find work (236,000 more than last year) and a significant step backwards from the Uribe Administration's public goal to maintain unemployment in the single digits. The GOC, likewise, missed its inflation target of 4 percent with DANE announcing January 2 final 2008 inflation of 7.7 percent. On the trade side, Colombia ended the year with an anticipated trade deficit of USD 1.1 billion after the strong Colombian peso fueled record imports projected to total USD 42.9 billion--a 40 percent increase over 2007. At the same time, high prices for oil, coal and other commodities boosted Colombia's export revenues to USD 41.8 billion, according to preliminary DANE calculations, but export volumes declined and are expected to fall further in 2009 amid slackening

world demand;

¶3. (SBU) Minister Zuluaga and other GOC officials publicly attribute the slowdown to the global downturn, citing tightened international credit and reduced demand for Colombian commodities in the U.S., Europe and Asia. Local analysts from Colombia's largest foreign bank BBVA, Citibank, and the National Association of Industries (ANDI), however, say blaming the global crisis oversimplifies Colombia's slowdown, which they date back to interest rate and capital control decisions (ref B) in late 2007 and the negative trade impact of the peso's appreciation (ref C). Rather, they have told us the slowdown simply became more evident following the broader downturn in developed economies in 2008. Many observers also blame the high cost of food and fuel, two extended strikes in the transport sector, labor stoppages in the mining sector, and the slow pace of public investment in the first year of new municipal and departmental governments, as further bridles on 2008 performance.

Gloomy 2009 Ahead

¶4. (SBU) Based on the weak 2008 exit, the GOC has lowered its 2009 GDP public forecast to 3 percent, citing decreased consumer confidence, lower anticipated public revenues from mining, and higher import costs due to the weakening peso. Most local financial institutions and analysts, such as Fedesarrollo and ANDI, estimate growth closer to 2 percent while Central Bank President Juan Dario Uribe has warned growth could fall to 1 percent. In a private meeting with us on December 17, Minister Zuluaga said he expected 2009 growth

to fall between 1 and 2 percent and identified increased public investment as key to keeping the economy out of recession. Zuluaga admitted that GOC predictions of 2008 soft landing did not foresee the sudden decline in commodity prices, the tightening of international credit markets, or decrease in external demand, and policymakers were now in catch-up mode.

¶5. (SBU) Although a December poll of leading Colombian economists concluded that inflation would cool to 5.3 percent in 2009, Fedesarrollo estimates that unemployment could reach 13 percent in 2009 as the industrial sector contracts slightly (0.3 percent) and export revenues fall to as low as USD 32 billion based on declining sales to U.S. and Venezuela and lower commodity prices. Representatives of three of Colombia's largest export-driven employment sectors, cut flowers, coffee, and textiles, told us they are expecting decreased demand for their products in the U.S. and Europe, but expect the recent depreciation of the peso to help offset declines in demand. The three sectors have not yet experienced significant reductions in employment. However, most analysts anticipate decreases in remittances from expatriate Colombians in 2009, lower foreign direct investment (FDI) from overstretched multinationals, and mounting consumer losses (estimated to reach as high as USD 1 billion) from the collapse of numerous illegal pyramid schemes (ref D) to further exacerbate Colombia's economic ailments.

Belt-tightening Underway

¶6. (SBU) Doubts are also growing that Colombia can maintain its fiscal deficit targets, already straining under competing security and social spending demands. Minister Zuluaga told us oil prices need to stabilize at USD 60 per barrel to avoid significant revenue declines from lower oil royalties and taxes. As a preemptive step, the GOC has already delayed USD 1.4 billion in 2009 spending, or 2.2 percent of the USD 67 billion budget, to avoid ballooning the fiscal deficit in the slowing economy. The GOC plans to limit most of the "postponed" spending to administrative costs such as official travel, communications, new hiring, etc. Minister Zuluaga said spending on social programs, infrastructure, and security will not be affected. Nevertheless, military,

police and counternarcotics officials have told Embassy MilGroup and NAS contacts that they expect tighter 2009 budgets and slower disbursements. The GOC will reevaluate whether to make the cuts permanent in mid-2009 after more revenue data is available. In the meantime, the budget, which allocates USD 35 billion to operations, USD 18 billion to debt service and USD 14 billion to investment, still represents a 13 percent increase from 2008.

¶7. (SBU) Besides budget cuts, Zuluaga said the GOC will complete the sale of state-owned electrical generator Isagen to help replace anticipated revenue shortfalls. In October GOC also arranged USD 2.4 billion in supplemental financing from the International Monetary Fund (IMF) and World Bank. Nevertheless, the GOC expects the recent declines Colombia's national debt (USD 45.8 billion) as a percentage of GDP to reverse from 21.7 percent in 2008 to 22.2 percent in 2009 due to more expensive financing costs. As a broader sign of belt-tightening, the GOC raised the 2009 minimum wage by only 7.7 percent (staying constant with inflation), despite labor's request for a 12.5 percent increase and DANE's own calculation that the cost of living for lowest income Colombians rose 8.8 percent in 2008.

How Do We Get Out of this Mess?

¶8. (SBU) According to Gallup, 50 percent of polled Colombians now say the economy is their top concern, up from 20 percent in May and more than double the 22 percent who cite public security. Meanwhile, President Uribe's popularity has slid from 75 percent in October to 70 percent in December, according to the same polling, and tension has grown in the GOC economic team after the resignations of Senior Advisor Cecelia Alvarez and Financial Superintendent Cesar Prado in the wake of the pyramid scandals, as well as the departure of long-time Tax Director Oscar Franco and rumors about Minister Zuluaga's potential exit,

¶9. (SBU) Amid this backdrop, GOC policymakers are busily searching for levers to stimulate the economy, but declining revenues, a lack of available international finance, and a large existing national debt burden leave little room for short-term fiscal stimulus. Most observers see monetary policy as the most practical recession-fighting tool left to the GOC. To this end, the Central Bank Board unanimously agreed December 19 to cut its benchmark interest rate from 10 percent to 9.5 percent. The cut represents the first rate reduction since 2006, and follows a growing chorus, led by President Uribe, to loosen monetary policy in an effort to head off recession. Ricardo Duran, Chief Analyst at brokerage firm Corredores Asociados, told us that the December 19 rate reduction was welcome, but must be followed by several more cuts to at least 8 percent to stave off recession.

¶10. (SBU) GOC officials have also announced plans to accelerate already-planned infrastructure investment, with USD 4.5 billion appropriated for the sector in 2009. GOC officials hope rising oil production, from 511,000 barrels per day (bpd) to 623,000 bpd over the last year, a profitable domestic banking sector, the removal of capital controls on foreign investment, USD 8 billion in FDI inflows in the first 9 months of 2008, high international reserves (USD 23.6 billion), and the stabilization of the Colombian peso will further cushion the Colombian economy from the worst effects of the global financial turmoil.

¶11. (SBU) ANDI President Luis Carlos Villegas told us that for Colombia to recover to the sustainable growth levels above 5 percent necessary for lasting poverty reduction, Colombia must innovate, look to new export markets (including Canada, Asia, and Central America), and seek new FDI sources such as China and the Middle East. Villegas recounted accompanying President Uribe at the November Asia-Pacific Economic Cooperation (APEC) meetings in Peru where Uribe met with 14 Asian heads of state to discuss investment in

Colombia--including postponing his return to Bogota until the middle of the night in order to meet with the Sultan of Brunei--as part of a growing GOC focus on diversifying economic partners. Nevertheless, Villegas emphasized that, as Colombia's largest trade and investment partner, it is very important for Colombia's long-term economic development to avoid letting the U.S.-Colombia Trade Promotion Agreement slide past 2009 without U.S. congressional ratification.
NICHOLS